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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C., 20554

FEB 7 1997
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests	)	MM Docket No. 94-150
	)	
Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry	)	MM Docket No. 92-51
	)	
Reexamination of the Commission's Cross-Interest Policy	)	MM Docket No. 87-154

To: The Commission

COMMENTS OF FOX BROADCASTING COMPANY

Fox Broadcasting Company ("FBC") hereby submits its Comments in response to the Commission's Further Notice of Proposed Rule Making, FCC 96-436 ("Attribution Notice"), released on November 7, 1996, in the above-captioned proceedings.

I. INTRODUCTION

Throughout the earlier phases of this proceeding, FBC consistently has taken the position that, after a decade of change in the broadcast industry, it is time to reevaluate and relax the Commission's attribution policies. Accordingly, FBC supports the Commission's continuing efforts to modify its attribution and

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ownership policies to comport with the competitive realities of the video marketplace.

But FBC is concerned that the Commission's new proposal to adopt a presumptive 33 percent "equity or debt plus" attribution standard for program suppliers would disserve the goals underlying these proceedings, both by depriving local broadcast outlets of needed capital, and by limiting the ability of program suppliers to make needed investments in their distribution infrastructure. Accordingly, for the reasons stated below, FBC urges the Commission not to adopt its proposed "equity or debt plus" attribution standard with respect to program suppliers.

II. SUBJECTING PROGRAM SUPPLIERS TO A PRESUMPTIVE 33 PERCENT "EQUITY OR DEBT PLUS" ATTRIBUTION STANDARD WILL REDUCE COMPETITION AND DIVERSITY.

The Commission's cross ownership rules are intended to promote the twin goals of diversity and competition. The attribution standards, in turn, are a mechanism for implementing those rules. If the current attribution standards are not adversely affecting diversity and competition, there is no need to expand the scope of attribution and thereby make the rules more burdensome. This is especially true where, as with the proposed "equity or debt plus" standard, the rules will have an adverse effect on the ability of local stations to attract needed capital and of program suppliers to strengthen their affiliates and secure distribution of their programming.

With increasing competitive pressure from cable television, DBS, wireless cable, and telecommunications companies, local broadcasters -- particularly underperforming UHF outlets -- must be able to attract the capital they need to survive and grow, especially as they make the transition to digital broadcasting. At the same time, in the face of growing competition for local outlets, program suppliers naturally seek to invest in and strengthen their local distribution infrastructure. These complementary objectives are completely consistent with the Commission's competition and diversity goals. See generally Haring, J., and Shooshan, H., "Focusing on the 'Success Mode': A Case for Deregulating National Broadcast Television Ownership," February 7, 1997 ("Deregulating Ownership") (attached hereto).

FBC respectfully submits that a rule that would deter entities such as FBC from investing in their local distribution infrastructure is completely contrary to the goals of competition and diversity. Indeed, investment in a local outlet by a program supplier produces beneficial results that extend far beyond the particular station involved. Improvements in a program supplier's distribution infrastructure make it feasible to invest in higher quality programming, which benefits a program supplier's other outlets and the local markets they serve. Such investment also enables local outlets, in turn, to allocate additional resources to the development and production of local programming. Id. at 11. Furthermore, program services such as FBC may be the most likely investors in weak UHF stations. Id. at 8. By suggesting that the "equity or debt plus" restriction is needed because program services may have an incentive to "work around" the existing attribution rules, the Commission is, in effect, acknowledging an unintended consequence of the current rules: they inhibit entry by efficient risk-sharers, with a corresponding cost to the public interest. Id. at 9.

There is extensive research to suggest that contractual arrangements between program suppliers and their affiliates may not be sufficient to generate the facilities improvements and programming expenditures needed to produce the sorts of public interest benefits noted above. See id. at 12-13. Yet the Commission's proposal to introduce an "equity or debt plus" attribution standard for program suppliers would deter precisely the sort of longer-term, more closely integrated relationships that can produce such benefits. Meanwhile, the highly competitive nature of the video program production and distribution markets undermines the argument that program suppliers and their local outlets are in a special relationship that should trigger attribution.

The fact is that a significant amount of actual or potential influence inheres in all of a licensee's important economic relationships -- with networks, with other program suppliers, with program producers, with advertisers, with lenders, and with regulators. National sales representatives, for example, exert significant influence over station sales and programming practices, and typically advise their station clients about what syndicated programs to buy. Such advice typically carries considerable "influence," yet is not deemed to create an attributable interest. The Commission has failed to identify a sufficient rationale for treating non-controlling equity interests, much less debt interests, held by program suppliers more restrictively than other kinds of business relationships.

If the Commission were truly to insist on being consistent in defining attribution in terms of perceived "influence," most network affiliation agreements, and syndication contracts requiring in-pattern clearance, would give rise to attribution. Restrictive covenants regarding financing, and consulting or management agreements, might also create attributable interests. The Commission can find in its own files numerous loan agreements which limit a licensee's discretion over a variety of operational issues such as capital and programming expenditures, debt-to-equity ratios, and changes in network affiliation. Such provisions can give lenders substantial influence over station operations, especially when the borrower is in default. Clearly, the Commission does not intend to extend its rules to reach these kinds of influence; indeed, banks and other lenders will not lend without securing numerous affirmative and negative covenants that give them the same degree of influence over broadcast borrowers as they have over other borrowers. If these kinds of covenants and the resulting non-controlling influence were to render the banks' interest attributable, most banks simply would not lend to broadcasters. FBC submits that there is no reasonable basis for concluding that the degree of potential influence that results from non-controlling equity investments or loans by program suppliers is likely to be greater than that which results from these kinds of relationships.

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Indeed, it is fair to state that there is currently more competition and more diversity in broadcasting than ever before. That competition acts as a safeguard against the very problem --potential overreaching by program suppliers -- the proposed standard is intended to prevent. First, licensees enter into affiliation and program contracts at their discretion and retain ultimate control of their facilities. They also retain the option of contracting with other parties. Second, existing regulations already guard against concerns of undue influence by program suppliers. As the Commission has recognized in these proceedings, both the Option Time and the Right to Reject rules, 47 C.F.R. § 73.658(d) and (e), respectively, prevent "program suppliers such as networks [from using] nonattributable interests to exert influence over critical station decisions, including programming and affiliation choices." Attribution Notice at ¶ 17. These regulations, together with the antitrust laws, would prevent program suppliers from exercising undue influence over critical station decisions. Meanwhile, entities such as FBC would be able to invest in local outlets in order to increase competition in markets throughout the country.

The Commission's apparent suspicion of local investment by program suppliers also threatens minority entrepreneurs. As the Commission has acknowledged, ownership opportunities for minorities depend in large measure on their access to capital. But such transactions are not likely to take place unless investors can make substantial, non-attributable investments which do not unduly restrict their ability to conduct business with the minority-controlled entities in which they are investing. The Commission must therefore avoid creating such restrictions through an unnecessary expansion of the attribution standards.

Investment by a program supplier such as FBC in its affiliates can affirmatively strengthen UHF stations and serve the public interest. Indeed, the experience of FBC suggests that network investment in affiliates may be the only way that it and other newer networks can strengthen weak affiliates to the point where they can compete effectively in their markets. Limiting the ability of program suppliers to invest in their affiliates, as the proposed changes would effectively do by expanding the definition of attributable interests, would ignore the realities of the broadcasting business, jeopardizing the development and growth of new networks and of stations at the local level.

Accordingly, as a matter of policy, the Commission should encourage program suppliers to invest in broadcasters, rather than preclude such investment. The demonstrable benefits of permitting program supplies to invest in their distribution systems far outweigh any theoretical harm.

III. CONCLUSION

While it is possible to impose arbitrary limits on certain levels of investment or involvement that seem somehow significant but do not constitute actual control, it is difficult to show that these markers delineate anything real. The Commission seeks to cast its attribution net more widely, to make sure that no untoward arrangement evades regulation, but it fails to show that the public interest is presently being harmed in ways that justify this expansion. To the contrary, imposing an arbitrary restriction on investment by program suppliers would increase restraints on capital and competition, without creating any identifiable benefits.

Respectfully submitted,

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February 7, 1997

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Focusing On the "Success Mode": A Case for Deregulating National Broadcast Television Ownership

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February 7, 1997

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SUMMARY

The radical transformation of the national video marketplace that has taken place over the last quarter century calls into question national ownership rules conceived of at a time when both outlets and program services were relatively scarce. National station ownership rules handicap broadcasters by denying them the full range of competitive synergies that their rivals are free to exploit. As a result, broadcasters will find it relatively more difficult to attract the capital they need to compete, including for the conversion of their operations and program services to ATV. Consumers lose valuable options (e.g., higher quality national *and* local programming). The harm is even greater for those consumers who rely disproportionately on broadcasting because they cannot afford other media.

Rather than focus on potential failure modes as a basis for regulation, the Commission should focus on the "success mode" that almost certainly would result from deregulation. Increased competition, better programming and a stronger television broadcasting infrastructure are ample benefits to justify "letting go."

Thus, the Commission should eliminate its national ownership rules. If it chooses not to, it should certainly not undercut the liberalization of those rules mandated by Congress by tightening its attribution rules so as to weaken broadcast networks.

I. Introduction

Communications markets are changing rapidly. Nowhere is this more apparent than in the explosion of new mass media outlets and services. The continuing growth of DTH services alone has blanketed the country with hundreds of new distribution channels. The Internet has become a significant communications pathway, with the potential of delivering video services that are on a par with broadcast television today. The steady growth of Fox Broadcasting, the emergence of the Warner Brothers and Paramount networks, the addition of several new cable networks each year (with dozens more waiting in the wings) and a wide range of on-line services with at least rudimentary video components all herald a national video marketplace characterized by competition and diversity, rather than by monopoly and scarcity. This is true, recent mergers notwithstanding.

Last year, Congress responded to the new reality by enacting sweeping legislation designed to create a new policy paradigm. The details of this new paradigm have been left to the FCC. Nowhere is it more important for the Commission "to get it right" than in revamping its rules relating to national television ownership.

The Telecommunications Act of 1996 ("the 1996 Act") required the FCC to relax its national television ownership rules. Congress instructed the Commission to drop its limits on the number of commonly-owned television stations and to expand its limitation on audience reach to 35 percent. The 1996 Act does not prevent the Commission from taking even bolder steps if they are justified. We believe they are.

In reviewing its national ownership rules, the Commission should focus on the "success mode"; that is the likelihood that good things will happen if regulation is withdrawn.

Especially, where it is clear (if not evident) that the Commission's national ownership rules stifle the efficient delivery of diverse programming and actually work to impede, not promote competition, the FCC should deregulate. Where competition effectively limits the exercise of monopoly/monopsony power, regulation serves no productive purpose. Such is the case with the Commission's restrictions on national ownership (*i.e.*, the 35 percent audience reach rule). Where regulation has the effect of tipping the competitive balance in favor of one delivery technology over another and of creating a barrier to new entrants, it should be especially suspect. Such is the case with the national ownership rules. These considerations should also inform the Commission's review of its related rules (*e.g.*, its attribution rules).

Before discussing the Commission's proposed treatment of "program suppliers" in its revised attribution rules as they relate to national ownership, we question the need for any national limits on broadcast station ownership (and, therefore, any attribution rules in that context).[1]

II. National Ownership Limits

The Commission's national ownership rules have, ironically in the name of promoting program diversity, actually become a roadblock inhibiting the development of new, competitive sources of programming. Given a highly competitive marketplace and significant economies of scale in program production, development of competitive programming is both expensive and risky. The transactions costs associated with putting together a viable set of stations (especially one consisting overwhelmingly of highly marginal fringe operations) capable of generating an audience sufficiently valuable to advertisers to cover broadcast and program costs are formidable, to say the least.[2] Overcoming these deterrents to investment may well require higher degrees of integration than

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1 We note that a similar limitation on the reach of cable MSOs (where such a rule has a much stronger public policy rationale; that is, concern about the extension of monopsony power by cable operators) has been struck down by the courts.

2 The logic of the Commission's rules amounts to saying that A should not be permitted to marry (notwithstanding the implausibility let alone any actual evidence of harm from so doing), because if A *is* permitted to marry, A may marry B, and if A marries B, A will not be available to marry C or D. Of course, if the goal is actually to produce families, rules preventing marriage are obviously hard to rationalize. Mere "availability" without the ability to commit does not lessen risk or encourage the sinking of investments. Prohibitions against marital contracts increase risks, deter marital investments and, thus, presumably discourage the formation of families.

existing rules or rule interpretations permit. That presents the Commission with a dilemma: Its rules restrict with a view ostensibly to promote diversity but the restrictions the rules impose limit rather than promote diversity.[3]

Permitting higher degrees of integration by removing limitations on national ownership and equity participation may well serve to permit effective rationalization of production that might otherwise prove infeasible. Risks may be reduced and shared more efficiently. Larger coalitions of stations may be rendered more feasible. The ability to induce investments in various shared resources may be enhanced. The ability to monitor and discourage opportunistic behavior that undermines enterprise viability may be facilitated. In all of these ways, opportunities for economizing on programming and other operating and marketing costs may be increased and more effective exploited, thus enhancing the chances of network viability.

The benefits of restricting national ownership of television stations in today's environment are difficult to fathom. We are awash in diversity and a variety of outlets for information and entertainment competing for people's attention and dollars. In particular, there are a substantial (and steadily growing)

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3 An important point to bear in mind is that limits on *national* ownership do not increase the diversity available to any individual. Thus, in the context of national ownership rules, concerns about "diversity" really come down to populist notions and political judgments about the acceptable size of mass media firms.

number of national program services all of which compete fiercely for national exhibition rights in what is, quite clearly, a national market.[4] If future growth of a group owner creates concerns that cannot adequately be addressed by enforcement of the antitrust laws, the Commission can always intervene in that particular case.

While there appear to be no benefits to restricting national ownership, there are costs. However, the costs (*i.e.*, sacrifice of higher quality broadcast programming and stronger local broadcast operations) may not be apparent because it is hard to miss what you have not had. Nevertheless, the adverse economic consequences of the Commission's uneconomic ownership restrictions are real and consist of the higher level of consumer satisfaction necessarily foregone as a result of the rules' operation.

In our view, elimination of the rules will produce no harm, but will empower existing marginal stations to become more effective competitors (strong national and local voices) capable of increasing the diversity of program options available to the public. The Commission should be bold in reconsidering its national ownership rules. Incremental changes won't suffice to salvage rules that serve to reduce, not promote competition and diminish, not increase diversity.

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4 We note, however, that much of the growth has come from the addition of new non-broadcast (*i.e.*, cable) networks. As we have suggested, the Commission's broadcast ownership rules have the perverse effects of strengthening other media and hurting consumers who rely on broadcasting because they cannot easily afford to subscribe to other media.

There is also a question of consistency. How can the Commission justify granting a "national" license to satellite broadcasters while restricting terrestrial broadcast station owners to no more than 35 percent of the market without ultimately relegating the latter to second-class status?

In today's video market, restrictions on national ownership also make it more difficult for new broadcast networks to emerge. The "prime real estate" (VHFs and stronger UHFs) is already taken. To survive, a new network may need to assemble less valuable parcels (weaker UHFs) in more markets (with greater reach); in other words, to produce competitive programming, the marginal network has to find ways of doing more with less. Where perceived risks are greater, means must be found to reduce risks. Where transactions costs of forming and operating an effective coalition of stations are higher, means must be found to economize on transactions costs. This may mean allowing a network to secure its interest through direct investment in order to provide the foundation for a new national broadcast program service.

In short, because new program services are thus inherently more risky, these services need more efficient ways to spread that risk if they are to succeed. Moreover, as competition increases from cable, satellite and other non-broadcast program services, even established broadcast networks will have to become more efficient if they are to compete effectively.

III. The Attribution Rules

Attribution rules go hand-in-hand with restrictions on ownership. The question posed is: what interests in broadcast stations will be attributed for purposes of applying the ownership rule in question?[5]

The Commission has tentatively concluded that it should tighten its attribution rules to prevent the circumvention of its national ownership rules by "program services." It has "determined" that networks will be more inclined to enter into contractual relationships in conjunction with a debt or equity position that will permit them to have *de facto* control of a station. The Commission has, therefore, proposed to make it more difficult (and more costly) for networks to make these investments.

Yet, precisely because it needs to strengthen its existing base or to assemble a new portfolio of stations, a network may be the most likely investor in weak

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5 Our analysis of the attribution rules addresses the Commission's proposal to tighten the standard where a "program supplier" is involved for purposes of applying its national ownership rules (*i.e.*, the 35 percent reach limit). We note that the Commission could, if it chooses, adopt different attribution rules for applying whatever national and local ownership restrictions are warranted. We see no reason why "program suppliers" should be singled out for stricter scrutiny in the application of either national or local ownership rules.

UHF stations. As such stations are upgraded, advertisers, (at least some) other program suppliers[6] and viewers benefit (the latter through more and better programming, including local news, etc.[7]). By suggesting that program services may have a special incentive to "work around" the attribution rules, the Commission is, in effect, acknowledging the unintended consequence of its own national ownership rules; that is, that they inhibit entry by efficient risk-sharers.

How is it good public policy to keep weak stations weak in the name of preserving local autonomy? At the margin, the FCC's option time and right to reject rules ensure that some autonomy is retained. Also, any investor has an interest in seeing that its investment earn the maximum return whatever his/her strategic interest in that investment might be. But, the real issue posed by the Commission's proposed change in its attribution rules is the economic future of broadcast television (especially marginal stations) when faced with increased

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[6] Program suppliers with high quality programming benefit from having a greater number of strong bidders whether it be to supply national (network) programming or local (syndicated) programming.

[7] As we wrote nearly two years ago: "Those who maintain that expanded network station ownership will reduce locally originated programming need to explain why previous relaxation of ownership restrictions has apparently *not* had that consequence. Network and group-owned stations typically do *more* local news and public affairs programming. The result of previous reform has apparently been more networking *and* more locally originated programming as well. Networking can create stronger local broadcast operations, and multiple station ownership can help facilitate the formation of competitively viable networks in an era of universal multimedia competition." J. Haring and H. Shooshan, "The Evolving Electronic Media Marketplace and the Devolving Case for Broadcast Ownership Restrictions," March 20, 1995, p. 9.

competition from cable, satellite, and other media, as well as with the considerable costs of conversion to ATV.

IV. The "Success Mode"

Economists frequently speak of so-called "failure modes;" *i.e.*, descriptions of various ways in which things may go wrong with less than maximal efficiency the unfortunate consequence. It is, however, also possible and useful to conjecture how particular policy changes can result in things going *right* with enhanced efficiency and greater consumer welfare the result. There is, in fact, a compelling economic basis for thinking that deregulation will have these types of salutary consequences.

This "success mode" starts with the observation that good programming generally costs a lot of money, and that to produce higher quality programming, larger amounts of capital must generally be invested in program development and production. Such large investments can only be justified when combined with a "distribution machine" capable of transmitting the programs to an audience sufficiently large that, when marketed to advertisers, enough revenue is produced to cover not only the development, production and distribution costs, but also to generate a competitive return on what is a highly risky investment.

In the case of a broadcast network, the distribution machine consists of individual stations and the communication links that tie them together. Note that, when investments are made to upgrade *the internal operations of individual stations* (whether they be for capital equipment, on-air personalities, news gathering capabilities, *etc.*), they produce *external effects for other stations* affiliated with the network. That is because such improvements make it feasible to invest in higher quality network program offerings which will redound to the economic benefit of all the other network participants.

Consider a simple example. Suppose an investment is made so that a "dark" station can commence operations. The network that includes this station now rationally calculates that larger program investments are warranted, given the additional commercial exposures its programming can produce with the new station having commenced operations. Larger investments produce higher quality programs, but higher quality programs, *ceteris paribus*, attract larger audiences on all the network's stations, so all benefit from the greater investment in local capabilities. As noted above, this argument is of quite general applicability in terms of the various different kinds of investments a capitalist would conceivably make in a local station operation.

The organizational problem for the network entrepreneur is how, organizationally, to effectively tie the different constituent parts of the success mode together to make it work. How is the whole enterprise to be organized so that incentives are properly aligned to induce the various different kinds of investments (*viz.*, improved local station operations, development of various shared resources, and higher quality programs)? A key problem confronting the combined enterprise is that individual stations, left to their own devices, will systematically tend to under-invest in upgraded capabilities. That is because they do not reap the benefits their investments generate for *other* stations. Unless stations can be induced to make the investments, the synergistic benefits of coordinated behavior cannot be fully realized.

From an organizational perspective, there is often a question of whether benefits can be effectively synthesized through various contractual arrangements rather than through common ownership. That is, given perceived advantages of integrated operations, is integration most efficiently achieved through incorporation/ownership or through arms-length transactions effected via contractual arrangements? There is extensive economic literature suggesting a variety of circumstances where contractual arrangements may not suffice to induce efficient behavior and where, consequently, more thoroughgoing methods of integration are required. These occur where efficient contractual arrangements require complex and correspondingly costly contracting, where long-term relationships and methods for effecting adaptive behavior are needed, and where threats of debilitating opportunistic behavior exist.

Creating a broadcast network as a means of internalizing the external effects we have described above is precisely the kind of activity wherein these kinds of properties are prevalent and where integration via more extensive ownership may thus be necessary for enterprise success. Several points should be noted in this regard: (1) if contractual arrangements were to be relied upon, they would likely have to be highly complex and, as a consequence, costly to negotiate and enforce; (2) if contractual arrangements were to be effective, they would likely end up closely resembling something akin to ownership; there would be a distinction but not really a difference; and (3) contractual arrangements capable of fully insuring against opportunistic behavior may simply not exist. To the extent contractual arrangements fail to produce sufficiently high levels of "comfort," investment incentives will be attenuated and the organization will fail to fully internalize the external benefits, which supply the motive for the enterprise in the first place.

The ability to overcome organizational hurdles assumes particular significance for new broadcast network enterprises. Such enterprises must rely on comparatively inferior component parts — marginal (generally UHF) stations operating in marginal locations. Their economic viability may turn critically on the ability to overcome transactional hurdles and to make needed investments sufficiently attractive. In this regard, it seems worth reiterating that poor programming or no programming (in the case of "dark stations") hardly makes a significant contribution to diversity. Nor is economic freedom enhanced by preventing voluntary exchanges that are mutually advantageous to the contracting parties and, moreover, produce significant benefits to third parties (*viz.*, the public that consumes broadcast programming).

The emergence of new national broadcast networks affiliated with Fox, Warner Brothers and Paramount are examples of the "success mode" we describe. These new national program services were made possible by the elimination of the Commission's restrictions on contractual relationships in the production and distribution of network programming (the so-called "fin/syn" rules). The Commission should seize on the opportunity Congress has provided to eliminate restrictions on contractual relationships that relate to national station ownership, not tighten them. In our view, there could be substantial benefits, *viz.*, higher quality national broadcast television services and greater choice resulting from new entry.

V. Conclusion

The radical transformation of the national video marketplace that has taken place over the last quarter century calls into question national ownership rules conceived of at a time when both outlets and program services were relatively scarce. National station ownership rules handicap broadcasters by denying them the full range of competitive synergies that their rivals are free to exploit. As a result, broadcasters will find it relatively more difficult to attract the capital they need to compete, including for the conversion of their operations and program services to ATV. Consumers lose valuable options (*e.g.*, higher quality national *and* local programming). The harm is even greater for those consumers who rely disproportionately on broadcasting because they cannot afford other media.

Rather than focus on potential failure modes as a basis for regulation, the Commission should focus on the "success mode" that almost certainly would result from deregulation. Increased competition, better programming and a stronger television broadcasting infrastructure are ample benefits to justify "letting go."

Thus, the Commission should eliminate its national ownership rules. If it chooses not to, it should certainly not undercut the liberalization of those rules mandated by Congress by tightening its attribution rules so as to weaken broadcast networks.